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NO. 91-1902

IN THE

Supreme Court of The United States

OCTOBER TERM, 1991

GREYSTONE III JOINT VENTURE,

Petitioner,

v.

PHOENIX MUTUAL LIFE INSURANCE COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT PHOENIX MUTUAL LIFE INSURANCE COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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BRIEF FOR RESPONDENT PHOENIX MUTUAL LIFE INSURANCE COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent Phoenix Mutual Life Insurance Company ("Phoenix") submits this brief in opposition to the petition ("Greystone's petition") of Petitioner Greystone III Joint Venture ("Greystone") for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit ("the Fifth Circuit"):

STATEMENT REGARDING PARTIES AND PURSUANT TO SUPREME COURT RULE 29.1

Greystone's petition (p. iii) accurately lists the parties. Phoenix owns (a) 30% of a corporation known as Phoenix Real Estate Corp., a Delaware corporation, the balance of the stock of which is owned by the public; (b) 98% of a corporation known as KWL of CT, Inc.; (c) 89% of a corporation known as Erickson Swan-Rowley of Jamestown, Inc.; (d) 84.2% of a corporation

known as McDowell Insurance, Inc.; and (e) 95% of a corporation known as American Brokerage of Philadelphia, Inc.

QUESTIONS PRESENTED

1. WHETHER CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE PERMITS CONFIRMATION, OVER THE OBJECTION OF AN UNDERSECURED NON-RECOURSE CREDITOR, OF A PLAN OF REORGANIZATION WHICH CLASSIFIES THE UNSECURED CLAIMS AGGREGATING $10,000 OF THE DEBTOR IN POSSESSION'S TRADE CREDITORS SEPARATELY FROM THE OBJECTING CREDITOR'S UNSECURED CLAIM OF $3,475,773.60 WHEN (A) THE PLAN PROPOSES TO DISCHARGE THOSE UNSECURED CLAIMS BY MAKING THE IDENTICAL MINUSCULE PERCENTAGE DISTRIBUTION TO EACH TRADE CREDITOR AND TO THE OBJECTING CREDITOR, (B) THE PURPOSE OF SUCH SEPARATE CLASSIFICATION IS TO OBTAIN THE IMPAIRED ACCEPTING CLASS REQUIRED FOR CONFIRMATION OF THE PLAN, AND (C) THE DEBTOR IN POSSESSION ADDUCES NO EVIDENCE OF ANY FACTUAL OR MOTIVATIONAL JUSTIFICATION FOR SUCH SEPARATE CLASSIFICATION ("the trade classification issue").

2. WHETHER TENANTS UNDER LEASES WHICH HAVE BEEN ASSUMED BY THE DEBTOR IN POSSESSION IN A CASE FOR RELIEF UNDER CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE HAVE CLAIMS FOR SECURITY DEPOSITS WHICH ENTITLE SUCH TENANTS TO VOTE ON THE DEBTOR IN POSSESSION'S PLAN OF REORGANIZATION ("the tenant claim issue").

OPINIONS BELOW

The opinion of the Fifth Circuit appears beginning at page A-6 of the appendix to Greystone's petition and is published at 948 F.2d p. 134. The opinion of the United States District Court for the Western District of Texas ("the District Court") appears beginning at page A-42 of the appendix to Greystone's petition and is published at 127 B.R. 138. The opinion of the United States Bankruptcy Court for the Western District of Texas ("the Bankruptcy Court") appears beginning at page A-72 of the appendix to Greystone's petition and is published at 102 B.R. p. 560.

JURISDICTION

The opinion of the Fifth Circuit was dated November 19, 1991. The Fifth Circuit's order partially granting rehearing was dated February 27, 1992. Greystone's petition was filed on May 27, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

ADDITIONAL PERTINENT STATUTORY PROVISIONS

In addition to the statutory provisions quoted in Greystone's petition (pp. 3-4), the following statutes are pertinent:

11 U.S.C. §101

(10) " 'creditor' means —

(A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor . . ."

11 U.S.C. §506 Determination of secured status

"(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, . . . is a secured claim to the extent

of the value of such creditor's interest in the estate's interest in such property, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. . . ."

11 U.S.C. §1111 Claims and interests

"(b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed . . . the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse . . ."

11 U.S.C. §1126 Acceptance of plan

"(c) A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds an amount and more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan."

11 U.S.C. §1129 Confirmation of plan

"(a) The Court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

* * *

(8) With respect to each class of claims or interests —

(A) Such class has accepted the plan; or

(B) Such class has not impaired under the plan.

* * *

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

* * *

(b)(1) . . . if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."

STATEMENT OF THE CASE

A. Relevant facts.

Greystone was a Texas joint venture the principal asset of which was an office building ("the building") located in Austin, Texas. Phoenix was the owner and holder of a non-recourse promissory note ("the note") in the original principal amount of $8.8 million executed by Greystone. Payment of the note was secured by a first lien deed of trust ("the deed of trust") encumbering the building.

On the eve of a scheduled foreclosure of the deed of trust, Greystone commenced in the Bankruptcy Court a voluntary case ("Greystone's Chapter 11 case") for relief under Chapter 11 of the United States Bankruptcy Code ("the Code"). As of the commencement of Greystone's Chapter 11 case, the unpaid balance of principal and interest owing on the note was

$9,300,773.60. In Greystone's Chapter 11 case the Bankruptcy Court determined that the value of the building was $5,825,000. Phoenix thus filed in Greystone's Chapter 11 case proofs of Phoenix's secured claim of $5,825,000 ("Phoenix's secured claim") and Phoenix's unsecured deficiency claim of $3,475,773.60 ("Phoenix's unsecured claim").

Greystone subsequently proposed a plan of reorganization ("Greystone's plan") in Greystone's Chapter 11 case. Greystone's plan classified Phoenix's unsecured claim separately from the unsecured claims aggregating $10,000 of Greystone's trade creditors ("the trade creditors"), and proposed that Greystone discharge Phoenix's unsecured claim and the trade creditors' unsecured claims by distributing to Phoenix and the trade creditors 3.82% of each such unsecured claim. Additionally, Greystone's plan proposed another separate class consisting of unsecured "security deposit claims" of tenants ("the tenants") occupying space in the building pursuant to leases which Greystone had assumed subsequent to the commencement of Greystone's Chapter 11 case.

Greystone's plan initially provided that Greystone's general partner would remain liable for the balance of the trade creditors' unsecured claims and the tenants' "security deposit" claims; however, that provision was deleted orally at the hearing on confirmation of Greystone's plan.

The tenants and the trade creditors voted to accept Greystone's plan. Phoenix voted Phoenix's secured claim and Phoenix's unsecured claim to reject Greystone's plan, and objected to confirmation of Greystone's plan on the grounds, *inter alia*, that (a) Greystone's plan improperly classified Phoenix's unsecured claim separately from the trade creditors' unsecured claims for the purpose of obtaining the impaired accepting class required by Section 1129(a)(10) of the Code for confirmation of Greystone's plan; and (b) the tenants were not eligible to vote on Greystone's plan.

B. The decisions below.

The Bankruptcy Court confirmed Greystone's plan, *In re Greystone III Joint Venture,* 102 B.R. 560 (Bankr. W.D. Tex. 1989), reasoning that separate classification of the trade creditors' unsecured claims from Phoenix's unsecured claim was permissible because (a) Section 1122 of the Code " 'does not require that similar classes be grouped together but merely that any group be homogeneous' " 102 B.R. at 568; (b) if "some independent reasonable grounds for separate classification must be found," one such reasonable ground was "a demonstrated economic need to treat certain otherwise similar claims differently" and another was the "legal character of a claim" 102 B.R. at 569; and (c) both grounds were present in Greystone's Chapter 11 case, in that under state law Phoenix's "Code-created deficiency claim" was "subtly different from that of the trade debt," and by directing "the trade to the general partners who are anticipated to pay their claims in satisfaction of their liability" under Texas law, Greystone's plan treated the trade creditors "somewhat differently, in recognition of their unique legal rights against the partners, rights which a Code-created deficiency claim can not enjoy" 102 B.R. at 570. Alternatively, the Bankruptcy Court opined that "good business reasons also justify separate treatment" because trade creditors do "not extend credit to an entity based on that entity's long-term ability to pay the debt back, but on the entity's short-term cash flow" and "if those expectations are frustrated, creditors holding such debt have little recourse but to refrain from doing business with the enterprise" creating a "negative reputation" which "quickly spreads in the trade community making it difficult to obtain services in the future on any but the most onerous terms" 102 B.R. at 570. The Bankruptcy Court interpreted the Fifth Circuit's opinion in *Brite v. Sun Country Development, Inc. (In re Sun Country Development, Inc.),* 764 F.2d 406 (5th Cir. 1985) to condone " 'intentional' impairment" of claims, reasoning that the "only 'brake' on impairment appears to be the requirement . . . that the plan not 'unfairly discriminate' against a dissenting class of creditors" and that no

such unfair discrimination was present in Greystone's Chapter 11 case because Greystone's plan "assiduously accorded its trade debt precisely the same dividend as it has [Phoenix's] Code-created deficiency claim" and the two classes thus "have the same relative legal priority of claim upon the estate's assets and are accorded the same percentage of payment out of those assets" 102 B.R. at 571-72.

The District Court affirmed the Bankruptcy Court's confirmation of Greystone's plan, *In re Greystone III Joint Venture,* 127 B.R. 138 (W.D. Tex. 1990). It adopted the Bankruptcy Court's approval of the separate classification of Phoenix's unsecured claim from the unsecured claims of the trade creditors and the tenants, 127 B.R. at 140-141, and alternatively held that because the tenants' class constituted "an impaired class within the meaning of the Code" the acceptance of Greystone's plan by the trade creditors' class was unnecessary, 127 B.R. at 144.

The Fifth Circuit reversed the District Court and the Bankruptcy Court, *Phoenix Mutual Life Insurance Company v. Greystone III Joint Venture (In re Greystone III Joint Venture),* 948 F.2d 134 (5th Cir. 1991), holding that under Section 1122 of the Code "ordinarily substantially similar claims, those that share common priority and rights against the debtor's estate, should be placed in the same class" and that the Bankruptcy Court and District Court failed to "adhere to the one clear rule that emerges from otherwise muddled case law: thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan" 948 F.2d at 139. The Fifth Circuit's *Greystone* opinion (a) reasoned that although Section 1122(a) of the Code "only governs permissible *inclusions*" (emphasis the Fifth Circuit's) of claims in a class, if Section 1122(a) was "wholly permissive regarding the creation" of separate classes, the authorization in §1122(b) of the Code of a separate class of smaller unsecured claims would be unnecessary, rendering Section 1122(b) of the Code "superfluous, a result that is anathema to elementary principles of statutory construction" 948 F.2d at

138-39; (b) rejected the Bankruptcy Court's interpretation of *Sun Country* to condone artificial impairment of claims because "that case allowed the debtor to impair a previously unimpaired class of creditors not for purposes of vote getting but because the debtor belatedly discovered that it did not have sufficient funds to pay the creditors' claims in full" 948 F.2d at 139; (c) rejected the Bankruptcy Court's rationale that Phoenix's lack of recourse against Greystone under Texas law justified separate classification of the trade creditors' unsecured claims because "state law is irrelevant where, as here, the Code has eliminated the legal distinction between non-recourse deficiency claims and other unsecured claims" citing Section 1111(b)(1)(A) of the Code, 948 F.2d at 139; (d) rejected the Bankruptcy Court's finding that "good business reasons" justified separate classification of the trade creditors' claims because this finding "fails to distinguish between the *classification of claims* and the *treatment of claims*" (emphasis the Fifth Circuit's), "there is no separate treatment of the trade creditors in this case" and, in any event, the finding was "without support in the record and must be set aside as clearly erroneous" 948 F.2d at 141; and (e) rejected the District Court's alternative holding that the tenants constituted an impaired class entitled to vote for Greystone's plan because "Greystone never rejected its leases with the tenants" and thus no support existed "for the assertion that the tenants' 'claims' entitled them to vote on Greystone's plan" 948 F.2d at 141-142.

SUMMARY OF REASONS FOR DENYING THE WRIT

Greystone's petition (pp. 10-13) seeks (a) review by this Court on certiorari of the trade classification issue pursuant to Supreme Court Rule 10.1(a), arguing that the Fifth Circuit's *Greystone* opinion "held that ordinarily all unsecured claims should be classified together" which "conflicts with holdings" of other United States Courts of Appeals; and (b) review by this Court on certiorari of the tenant claim issue pursuant to Supreme Court Rule 10.1(c), arguing that the "Fifth Circuit is

the first court of appeals to address the issue" and "the issue is important in the context of this case . . ." The grounds advanced in Greystone's petition as ostensible justification for review of either issue by this Court are without merit. As shown below, (a) review on certiorari of the trade classification issue is not warranted because the Fifth Circuit's *Greystone* opinion is entirely correct and not in conflict with any other United States Court of Appeals decision; and (b) review on certiorari of the tenant claim issue is not warranted because the tenant claim issue involves no important unsettled question of federal law.

REASONS FOR DENYING THE WRIT

A. *The Fifth Circuit's decision regarding classification of the trade creditors' unsecured claims separately from Phoenix's unsecured claim was entirely correct and not in conflict with any other United States Court of Appeals decision.*

The Fifth Circuit's *Greystone* opinion held that "ordinarily 'substantially similar claims,' those which share common priority and rights against the debtor's estate, should be placed in the same class" and that a clear rule has emerged which prohibits classifying "similar claims differently in order to gerrymander" the impaired accepting class required for confirmation by Section 1129(a)(10) of the Code, 948 F.2d at 139. Those holdings are entirely consistent with all of the decisions cited in Greystone's petition as ostensibly conflicting decisions. In one such ostensibly conflicting decision, *Teamsters National Freight Industry Negotiation Committee v. U.S. Truck Company (In re U.S. Truck Company),* 800 F.2d 581 (6th Cir. 1986), the Sixth Circuit stated that "there must be some limit on a debtor's power to classify creditors" because "unless there is some requirement of keeping similar claims together, nothing would stand in the way of a debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class" 800 F.2d at 586. The Sixth Circuit in *U.S. Truck Company* upheld separate classification of a union negotiating committee's

claim from other unsecured claims not because the debtor was free to gerrymander claims but because the negotiating committee had a "virtually unique" non-creditor interest, 800 F.2d at 587.

In another ostensibly conflicting decision, *Olympia & York Florida Equity Corp. v. Bank of New York (In re Hollywell Corp.)*, 913 F.2d 873 (11th Cir. 1990), the Eleventh Circuit stated, "If the plan unfairly creates too many or too few classes, if the classifications are designed to manipulate class voting, or if a classification scheme violates basic priority rules, the plan cannot be confirmed" 913 F.2d at 880. The Eleventh Circuit in *Olympia* held that the potential benefit of a party affiliated with the debtor in possession from payment of the claim of a joint venture by virtue of the affiliated party's interest in the venture, and the joint venture's right to obtain satisfaction of its claim from the affiliated party's interest in the venture, did not justify classifying the venture's claim separately from other unsecured claims, 913 F.2d at 879-880.

In *Hanson v. First Bank of South Dakota,* 828 F.2d 1310 (8th Cir. 1987), a third supposedly conflicting decision, the Eighth Circuit stated that debtor's "discretion to place similar claims in different classes is not unlimited" and that classifications "designed to manipulate class voting must be carefully scrutinized" because "there is potential for abuse when the debtor has the power to classify creditors in a manner to assure that at least one class of impaired creditors will vote for the plan, thereby making it eligible for the cram-down provisions" 828 F.2d at 1313. Indeed, the Eighth Circuit in *Hanson* specifically rejected the contention that the "unsecured claims and the undersecured portions of claims are not substantially similar and therefore may be placed in separate classes," reasoning that this "distinction alone does not warrant separate classification . . . because under the Code the undersecured portion of a claim is an unsecured claim . . ." 828 F.2d at 1313.

In a fourth ostensibly conflicting decision, *In re Jersey City Medical Center*, 817 F.2d 1055 (3rd Cir. 1987), the Third Circuit, immediately after stating that "authorities recognize that the classification of the claims or interests must be reasonable," quoted the Sixth Circuit's statement in *U.S. Truck Company* that unless " 'there is some requirement of keeping similar claims together, nothing would stand in the way of a debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class.' " 817 F.2d at 1061.

In the final supposedly conflicting decision, *Barnes v. Whelan*, 689 F.2d 193 (D.C. Cir. 1982), the District of Columbia Circuit upheld a plan's separate classification of unsecured claims not for purposes of gerrymandering votes but to accommodate the plan's different treatment of the separate classes; the Sixth Circuit stated, "Clearly some difference in treatment between classes is permissible, or there would be little point in creating separate classes in the first place" 689 F.2d at 201.

Thus, the holdings in the Fifth Circuit's *Greystone* opinion that "ordinarily 'substantially similar claims' . . . should be placed in the same class" and that similar claims may not be classified separately "in order to gerrymander" votes are totally consistent with all of the ostensibly conflicting decisions cited in Greystone's petition. The holdings are, moreover, clearly correct; as this Court stated in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), the "Code provides that undersecured creditors can vote in the class of unsecured creditors . . ." 485 U.S. at 206-207.

The Fifth Circuit's *Greystone* opinion, 948 F.2d at 138-39 appropriately reasoned that although Section 1122(a) of the Code governs only permissible inclusions of claims in a class, if Section 1122(a) was "wholly permissive regarding the creation of" separate classes, Section 1122(b) of the Code, which authorizes a separate class of smaller unsecured claims, would be rendered "superfluous, a result that is anathema to elementary

principles of statutory construction." Greystone's petition (pp. 18-19) argues that this is a "forced reading of congressional intent" because "Section 1122(b) is merely an example of permissible classification" (pp. 18-19). However, if Section 1122(a) of the Code was wholly permissive regarding separate classification of claims, any such "example" of permissible separate classification would be unnecessary because all separate classification would be permissible, rendering Section 1122(b) of the Code superfluous which indeed, as the Fifth Circuit's *Greystone* opinion aptly stated, is "anathema to elementary principles of statutory construction" *see United States v. Menasche,* 348 U.S. 528, 538-39 (1955) (" 'The cardinal principle of statutory construction is to save and not to destroy' . . . It is our 'duty to give effect, if possible, to every clause and word of a statute' . . ."); *Platt v. Union Pacific Railroad Company,* 99 U.S. 48, 58 (1878) (". . . the admitted rules of statutory construction declare that a legislature is presumed to have used no superfluous words. Courts are to accord a meaning, if possible, to every word in a statute").

Citing certain legislative history to Section 1122 of the Code, Greystone's petition (p. 19) additionally asserts that in adopting Section 1122(b) of the Code, "Congress wished to codify pre-code practice with respect to administrative convenience claims." However, as the Sixth Circuit observed in *U.S. Truck Company,* the legislative history of Section 1122 of the Code does not support Greystone's position because that legislative history "indicates that Congress may not have intended to change" a "prior rule" which "was interpreted to require all creditors of equal rank with claims against the same property to be placed in the same class" 800 F.2d at p. 585.

Greystone's petition (pp. 20-21) further argues that although the Fifth Circuit's *Greystone* opinion stated that "ordinarily 'substantially similar claims' . . . should be placed in the same class" the Fifth Circuit's *Greystone* opinion "did not state any circumstances in which the exceptions to the ordinary rule would be permitted" and the Fifth Circuit's *Greystone* opinion

thus "has the effect of a conclusive presumption." This argument is foolish. The Fifth Circuit had no authority to, and did not, render an advisory opinion regarding which "exceptions to the ordinary rule would be permitted" *McGrath v. Kristenson,* 340 U.S. 162, 167, n. 6 (1950) ("Federal constitutional courts can act only on cases and controversies and do not give advisory opinions"); failure of the Fifth Circuit's *Greystone* opinion to render such an advisory opinion thus created no improper "conclusive presumption".

Greystone's petition (pp. 23-24) then argues that the Fifth Circuit's *Greystone* opinion placed "too much importance upon the role of classification" because (a) Section 1122 of the Code "is not the guardian of similar treatment among similar claims"; (b) the legislative history to Section 1129(b)(1) of the Code states that a plan "may not be confirmed unless 'the class is not unfairly discriminated against with respect to equal classes' " which "apparently refers to multiple classes of unsecured claims," meaning that Section 1129(b)(1) of the Code "was intended to prevent discriminatory treatment among multiple classes of unsecured claims"; and (c) Section 1122 "is found within the procedural sections of Title 11", and thus "does not play a major substantive role under the Code." These arguments are nonsense.

Obviously, Section 1129(b)(1) of the Code was not intended simply to "prevent discriminatory treatment among multiple classes of unsecured claims"; by its express terms, it prohibits unfair discrimination "with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." Moreover, neither the applicability of Section 1129(b)(1) to "multiple classes of unsecured claims" nor the placement of Section 1122 of the Code "within the procedural sections of Title 11" would render the "role of classification" and

Section 1122 of the Code as meaningless as Greystone's petition suggests:

> "Classification of claims occupies a central part of the structure of Chapter 11 [Under Section 1129(a)(1) of the Code] the Bankruptcy Court may confirm a plan only if it complies with all provisions of Chapter 11. The provisions stipulating the contents of a plan require the plan to include details on designation of classes of claims and interests in treatment of any impaired class. The plan also must comply with the classification standards which are found in Section 1122 . . ."

Blair, *Classification of Unsecured Claims in Chapter 11 Reorganization,* 58 American Bankr. L. J., 197, 199-200 (1984).

Greystone's petition (pp. 25-35) then contends that the Fifth Circuit's *Greystone* opinion erroneously condemned gerrymandering of claims to obtain the impaired accepting class required by Section 1129(a)(10) of the Code because (a) the Sixth Circuit in *U.S. Truck Company* "allowed the separate classification even though it was intended to satisfy the requirement of Section 1129(a)(10)"; (b) the Fifth Circuit in *Sun Country* "held that it was permissible for a debtor to use the impairment power in order to meet the requirements of" Section 1129(a)(10) of the Code; (c) Section 1129(a)(10) of the Code "merely requires that the plan be accepted by an impaired class of claims," was not "proposed for any purpose related to cram-down," and does not "grant veto power to" large creditors; and (d) therefore, "because no veto was contemplated, multiple classes of claims do not dilute a creditor's voting rights and no restriction on gerrymandering is necessary or proper." These arguments have several flaws.

First, although the Sixth Circuit in *U.S. Truck Company* noted the debtor's admission that the "purpose of separate classification was to line up the votes in favor of the plan" 800 F.2d at 586, n. 8, the Sixth Circuit did not expressly or implicitly condone

that practice. On the contrary, the Sixth Circuit cautioned that unless "there is some requirement of keeping similar claims together nothing would stand in the way of a debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class" 800 F.2d at 586, and upheld separate classification of the union negotiating committee's claim only because of the negotiating committee's "virtually unique" and "non-creditor interest" 800 F.2d at 587. Furthermore, *Sun Country* is not authority for the proposition that a debtor may artificially impair or gerrymander claims to obtain the requisite impaired accepting class. As the Fifth Circuit's *Greystone* opinion stated, *Sun Country* "allowed the debtor to impair a previously unimpaired class of creditors not for purposes of vote getting but because the debtor belatedly discovered that it did not have sufficient funds to pay the creditors' claims in full" 948 F.2d at 139. Contrary to Greystone's petition, Section 1129(a)(10) of the Code clearly was proposed for a "purpose related to cram-down." While Section 1129(a)(10) of the Code does not expressly "grant veto power to" large creditors, the "Code provides that undersecured creditors can vote in the class of unsecured creditors" *Ahlers, supra,* 485 U.S. at 206-207, and the requirement in Section 1129(a)(10) of the Code of "affirmative acceptance by at least one impaired class" for confirmation of a plan "cannot be ignored" *In re Barrington Oaks General Partnership,* 15 B.R. 952, 970 (Bankr. D. Utah 1981). Thus, the Fifth Circuit's *Greystone* opinion correctly held that gerrymandering similar claims to obtain the requisite impaired accepting class is totally improper.

Greystone's petition (pp. 35-37) next argues that "if there must be 'some limit' on the debtor's classification power, the strict test applied by the" Fifth Circuit's *Greystone* opinion "is not required" and decisions such as *In re Jersey City Medical Center, supra,* and *In re Le Blanc,* 622 F.2d 872 (5th Cir. 1980), furnish "the proper standard for reviewing the classification in this case." As shown above, however, immediately after the statement that "the classification of the claims or interests must

be reasonable" the Third Circuit in *Jersey City* quoted the Sixth Circuit's statement in *U.S. Truck Company* that unless " 'there is some requirement of keeping similar claims together, nothing would stand in the way of debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class.' " 817 F.2d at 1061. Thus, the standard for classification adopted by the Third Circuit in *Jersey City* was completely consistent with the standard adopted by the Fifth Circuit's *Greystone* opinion.

The Fifth Circuit's *Le Blanc* decision is totally inapplicable. *Le Blanc* involved the propriety of placing insiders with unsecured claims that were to receive nothing under a plan in a separate class from other unsecured creditors who were to receive distributions under the plan. It did not involve the propriety of separate classifications of similar claims for the purpose of gerrymandering votes to obtain an impaired accepting class. Indeed, the unsecured creditors in *Le Blanc* were not eligible to vote on the plan because *Le Blanc* was a case under Chapter XII of the United States Bankruptcy Act and "there was no equity in the debtor's property for distribution to unsecured creditors", 622 F.2d at 879 (Citing the holding in *In re Hamburger,* 117 F.2d 932 (6th Cir. 1941) that unsecured "creditors have no place in Chapter XII proceedings unless equity remains after payment of secured claims").

Greystone's petition (pp. 37-38) further argues that the Fifth Circuit's *Greystone* opinion erroneously held that the "state law distinction between Code-created unsecured deficiency claims and other unsecured claims does not alone warrant separate classification" because (a) several "courts have recognized the propriety of separately classifying non-recourse deficiency claims from those of trade creditors," citing certain bankruptcy court decisions including *In re Bjolmes Realty Trust,* 134 B.R. 1000 (Bankr. D. Mass. 1991); and (b) the "District of Columbia Circuit has allowed separate classification based upon third-party liability," citing *Barnes v. Whelan, supra*. However, no

United States Court of Appeals has "recognized the propriety of separately classifying non-recourse deficiency claims from those of trade creditors." On the contrary, at least one United States Court of Appeals has refused to do so and adopted the holding on that issue in the Fifth Circuit's *Greystone* opinion. In *Travelers Insurance Company v. Bryson Properties XVIII (In re Bryson Properties XVIII),* _____ F.2d _____, 22 BCD 1391 (4th Cir. 1992) the Fourth Circuit held:

> "Even if we adopt a flexible approach to Section 1122, however, the classification scheme at issue is impermissible. Where all unsecured claims receive the same treatment in terms of plan distribution, separate classification on the basis of natural and unnatural recourse claims is, at a minimum, highly suspect. In this case, Bryson has failed to offer any reason for separate classification of the unsecured claims which will withstand prudent scrutiny. The classification is clearly for the purpose of manipulating voting and it may not stand."

_____ F.2d _____, 22 BCD at 1343.

In *Barnes v. Whelan, supra,* the District of Columbia Circuit upheld separate classification of claims based not upon "third-party liability" but upon the separate treatment received by the classes; the plan classified "creditors holding co-signed debts guaranteed by third parties" who received "100% payment" separately from "other unsecured creditors" who "receive only 1% of their claims," and the court stated that "some difference between classes is permissible, or there would be little point in creating separate classes in the first place" 689 F.2d at 200-201.

Moreover, a bankruptcy court in the same district as the court which decided *Bjolmes Realty* has held that *Bjolmes Realty* was incorrectly decided. In *In re Cantonwood Associates Limited Partnership,* 138 B.R. 648 (Bankr. D. Mass. 1992), the court wrote:

> "The Court finds that legally and factually the debtor's classification scheme is improper, as creditors of equal rank have not been placed in the same class. Moreover, the Court respectfully disagrees with the decision in . . . *Bjolmes Realty* . . . holding that the undersecured creditor's right to make an election under 11 U.S.C. §1111(b) warrants separate classification."

138 B.R. at 657.

The holdings in the Fifth Circuit's *Greystone* opinion, the Fourth Circuit's *Bryson* opinion and the Massachusetts Bankruptcy Court's *Cantonwood* opinion are eminently correct. Section 1111(b)(1)(A) of the Code provides that a "claim secured by a lien on property of the estate shall be allowed or disallowed . . . the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse" with exceptions not relevant to Greystone's Chapter 11 case. Thus, for purposes of Chapter 11 of the Code, any distinction under state law between Phoenix's unsecured claim and the trade creditors' unsecured claims was eliminated.

Finally, Greystone's petition (pp. 38-40) contends that classifying the trade creditors' claims separately from Phoenix's unsecured claim was proper because (a) the claims were "factually separate" in that "trade creditors furnish goods and services with a reasonable expectation of being paid on a prompt basis" but "deficiency creditors intentionally entered into a long-term standing relationship on a secured basis" and "several cases recognize the propriety of separate classifications for trade creditors"; and (b) Phoenix and the trade creditors had "different motivation . . . for voting upon the plan", in that "trade creditors, as pure unsecured creditors, had an incentive to work with the debtor to obtain payment of their claims and to continue to do business with the reorganized debtor" but Phoenix "indicated by its actions that it was voting its unsecured claim for the purpose of putting the debtor out of business," quoting language in

Bjolmes Realty as authority for this argument. As the Fifth Circuit's *Greystone* opinion stated, 948 F.2d at 141, these arguments are specious because they fail "to distinguish between the *classification* of claims and the *treatment* of claims" (emphasis the Fifth Circuit's). Indeed, in each of the decisions cited in Greystone's petition for the proposition that "several cases recognize the propriety of separate classifications for trade creditors," each separate class received different treatment under the plan. On the other hand, the Bankruptcy Court's *Greystone* opinion acknowledged that Greystone's plan "assiduously accorded its trade debt precisely the same dividend as it has its Code-created deficiency claim" and that the "two classes of claims have the same relative legal priority of claim upon the debtor's assets and are accorded the same percentage of payment out of those assets" 102 B.R. at 571-72. *See Bryson Properties XVIII, supra,* _____ F.2d _____, 22 BCD at 1393. Moreover, Greystone offered no evidence of any factual or motivational basis for such separate classification, no evidence of a limited market for trade goods and services, and no evidence that Greystone would be unable to obtain any of the trade services if the trade creditors did not receive preferential treatment under Greystone's plan; thus, the Fifth Circuit's *Greystone* opinion held that the "Bankruptcy Court's finding that there were good business reasons for separate classification is without merit in the record and must be set aside as clearly erroneous" 948 F.2d at 141. That holding is correct. "If a finding is not supported by substantial evidence, it will be found to be clearly erroneous" 9 Wright & Miller Federal Practice & Procedure Section 2585, p. 735 (1971). Indeed, in expressing disagreement with the Massachusetts Bankruptcy Court's decision in *In re Bjolmes Realty Trust,* the Massachusetts Bankruptcy Court in *Cantonwood Associates* pointed out that such a finding of "good business reasons for separate classification" could not be supported by credible evidence:

> "... the Debtor argues that ... it is prepared to offer evidence as to good business reasons for separately classifying trade claims, the holders of which retain the

> right to pursue the general partners of Cantonwood to satisfy their claims in full. . . . The Debtor in its memorandum suggests that maintaining friendships between the tenants and the cleaning and security providers is critical to the Debtor's first-class reputation. However, the Debtor does not suggest, and, in view of the economic woes engendered by the present recession credibly cannot suggest, that there is a limited market for the trade goods and services in Canton and neighboring communities, or that the Debtor would be unable to obtain any trade services. . . . Moreover, since the trade creditors have recourse against the Debtor's general partner, the Debtor's implicit suggestion that the trade creditors will cease to provide services at the Debtor's property, thereby eroding the first-class reputation of the Westwood Business Centre, is simply unbelievable"

138 B.R. at 656-57. This valid rationale is equally applicable to Greystone's Chapter 11 case. Thus, Greystone failed to adduce any evidence to support the argument that "good business reasons" supported separate classification and, for the reasons stated in *Cantonwood*, could not credibly have done so.

B. *The tenant claim issue raises no important question of federal law which has not been, but should be, settled by this Court.*

The Fifth Circuit's Greystone opinion reversed the District Court's determination that the tenants constituted an impaired class which was entitled to vote on Greystone's plan, reasoning that (a) tenants under leases which the debtor in possession neither assumes nor rejects have "no provable claim against the bankruptcy estate"; (b) a "party to a lease is considered a 'creditor' who is allowed to vote . . . only when the party has a claim against the estate that arises from *rejection* of a lease (emphasis the Fifth Circuit's)"; (c) if the debtor in possession "assumes a lease, the lessee has no 'claim' against the debtor" because the "rights created by assumption of the lease constitute a post-petition administrative claim" and "the holder of such a claim is

not entitled to vote on a plan of reorganization" 948 F.2d at 141-142. This holding is clearly correct. In *National Labor Relations Board v. Bildisco & Bildisco,* 465 U.S. 513, 531-32 (1984), this Court stated that when a debtor in possession assumes an executory contract "the expenses and liabilities incurred may be treated as administrative expenses, which are afforded the highest priority on the debtor's estate," and holders of claims for such administrative expenses are ineligible to vote on a plan of reorganization, *In re Distrigas Corp.,* 66 B.R. 382, 385-86 (Bankr. D. Mass. 1986).

Greystone's petition (p. 44) asserts that one of the decisions cited in the Fifth Circuit's *Greystone* opinion was a "decision under the Bankruptcy Act which speaks in terms of 'provability' of a claim" and the "concept of provability was abandoned when the Bankruptcy Code was adopted." However, numerous decisions under the Code have applied the concept of the "provability" of a claim under a lease or other executory contract which the debtor in possession has not rejected, *Public Service Company of New Hampshire v. New Hampshire Electric Cooperative, Inc. (In re Public Service Co. of New Hampshire),* 884 F.2d 11, 15 (1st Cir. 1989) ("In this case, PubServe has neither assumed nor rejected the sell-back contract. . . . In such circumstances, the contract continues in effect — and appellant has no provable claim thereunder against the bankrupt estate"); *In re Stanley — Southwest Investments, Inc.,* 96 B.R. 696, 700 (Bankr. W.D. Tex. 1988) (An " 'unexpired lease, otherwise not assumed or rejected . . . does not give rise to a provable claim against the Debtor' "); *In re OPM Leasing Services, Inc.,* 79 B.R. 161, 164 (Bankr. S.D. N.Y. 1987) ("An unexpired lease, otherwise not assumed or rejected . . . does not give rise to a provable claim against the Debtor").

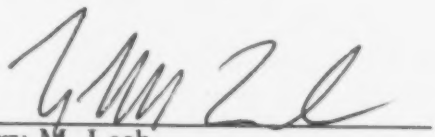
The decisions cited in Greystone's petition, *Confederation Life Insurance Company v. Beau Rivage Limited,* 126 B.R. 632 (N.D. Ga. 1991) and *In re Temple Zion,* 125 B.R. 910 (Bankr. E.D. Pa. 1991) are not contrary authority. The issue in those

decisions was whether classes were impaired within the meaning of Section 1124 of the Code. Neither case held that tenants under leases which the debtor in possession has not rejected are entitled to vote on a plan of reorganization. Therefore, the tenant claim issue raises no important unsettled question of federal law which has not been but shoulc be resolved by this Court.

CONCLUSION

Greystone's petition has failed to present any conflict in the decisions of the United States Courts of Appeals, or any important question of federal law which has not been, but should be settled by this Court. Accordingly, Phoenix submits that Greystone's petition should be denied.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I, Larry M. Lesh, a member of the Bar of the Supreme Court of the United States and counsel of record for Phoenix Mutual Life Insurance Company, Respondent, herein, hereby certify that on June 25, 1992, pursuant to Rule 33, Rules of the Supreme Court, I served three copies of the foregoing Brief for Respondent Phoenix Mutual Life Insurance Company in Opposition to Petition for Writ of Certiorari on each of the parties herein as follows:

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All parties required to be served have been served.

DATED: 6/25/92

Larry M. Lesh